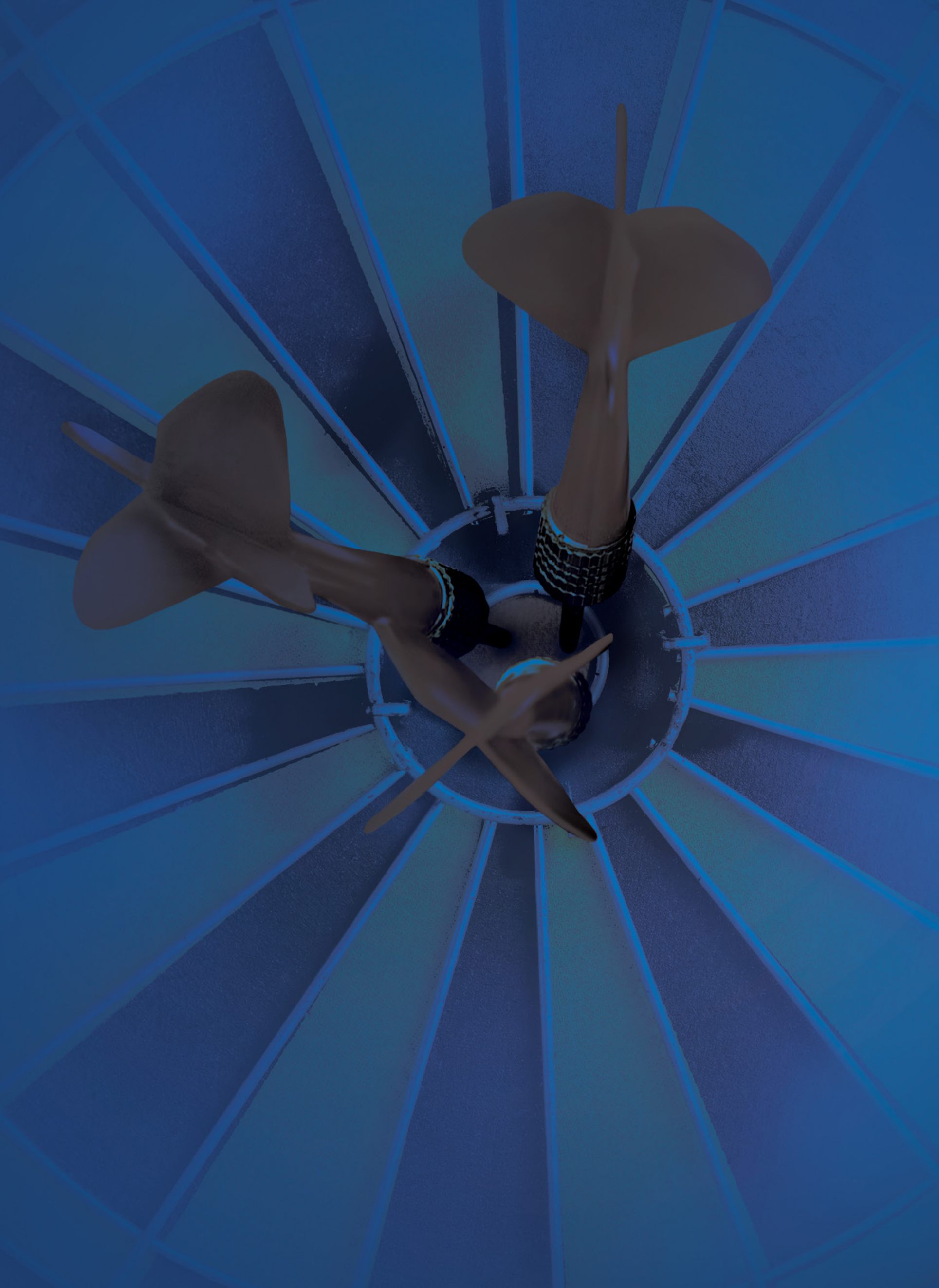
Fixed-Income Insights

Key Convictions 3Q23



One Team

With more than 50 years of experience, $388.0 billion* in assets under management and nine offices around the world, Western Asset is recognized as one of the world's leading active fixed-income managers.

One Platform

Western Asset operates as a single team with an open, integrated investment platform bringing together the combined experience and fixed-income acumen of investment professionals throughout the world.

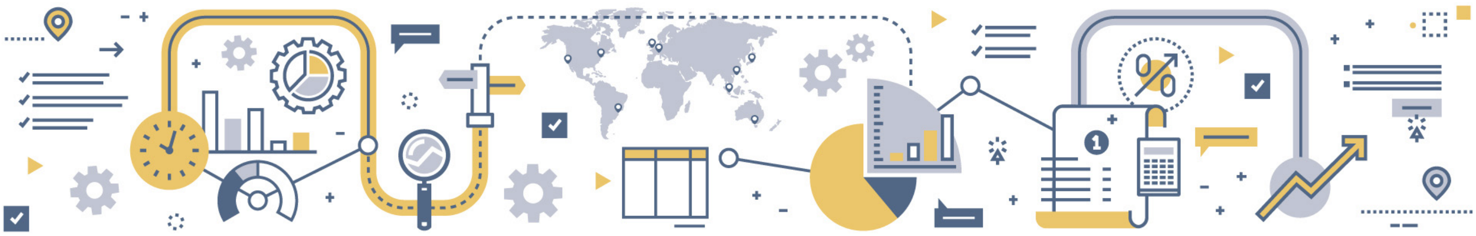
One Focus

Western Asset specializes in actively managing fixed-income strategies, employing a proven investment philosophy and process to protect capital and drive long-term investment growth for clients.

*As of June 30, 2023

Market Insights at a Glance

We remain cautious given risks of slowing growth and central bank overtightening but believe current spreads adequately compensate investors. The following summary is intended to aggregate the Firm's current overall views and present an at-a-glance dashboard.*



Growth

Convictions

- US growth is slowing but still resilient, and we expect the US will avoid a recession
- Global growth is broadly downshifting but is aided by factors such as the reopening of supply chains in China and a weaker dollar, which bodes well for emerging markets (EM)

Rationale

Slower US growth can be positive as it would help temper inflation without much harm; risks of a "hard landing" rise if the Fed tightens further.

Inflation

Convictions

- US inflation remains "sticky" but should continue to decline
- Inflation in Europe, especially in the UK, continues to remain prevalent
- Tailwinds coming out of the Covid pandemic that had been fueling inflation have either abated or even turned into headwinds

Rationale

We believe the disinflation process is ongoing but uneven, with "long and variable lags" still working their way through the system.

Rates

Convictions

- Interest rates are likely to trend lower once the Federal Reserve (Fed) achieves its terminal policy rate
- The yield curve has flattened due to policy tightening and recession fears

Rationale

Short-term interest rate volatility has been high, while longer-term rates are more attractive as we expect inflation to moderate over time.

Monetary Policy

Convictions

- In the US, the Fed may have a few hikes left; however, in the big picture, the heavy lifting has already been done
- In the UK, the Bank of England faces a very serious challenge in that UK inflation is climbing higher as the economy is worsening, with consumer confidence at all-time lows

Rationale

Containing inflation continues to be the primary focus of most developed market (DM) central banks.

Fiscal Policy

Convictions

- Fiscal stimulus and government spending during Covid drove economic demand, contributing to inflation
- Covid-related support is now reversing very meaningfully around the globe

Rationale

Fiscal drag from declining budget deficits should help reduce demand and curb inflation going forward.

Banking

Convictions

- Large US banks are in good shape given their balance sheet strength and regulatory scrutiny
- We expect large banks to grow stronger while weaker regional banks will likely consolidate

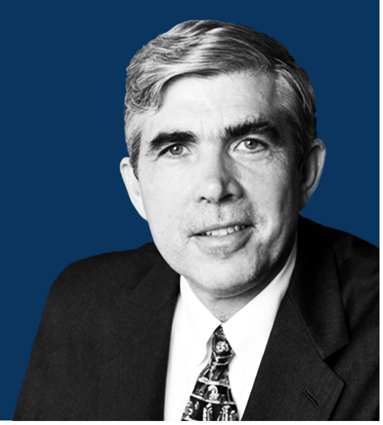
Rationale

Regional banks remain under stress and should continue to face pressure, but we don't see any systemic threats to the banks overall.

The Case for Higher-Quality Bonds

"There's enough yield and opportunity in the higher-quality bonds. They have a very high return with moderate risk [potential] that we believe is a better choice than taking some of the risk in the lower-quality bonds … you want to be thoughtful about quality in an environment where you've seen this extraordinary volatility and the Fed is interacting globally, regionally and reacting, as they said, so strongly to data points. It seems that it's better to focus and move up in quality because the probability of [monetary] policy mistakes has clearly risen. We think having strong views on inflation and having the wherewithal to be long duration and in spread product is important. But within this kind of environment, focusing on higher-quality parts of the sectors is a more prudent choice in our view."

— **Ken Leech**, Chief Investment Officer



**As of June 30, 2023*

Looking Ahead With Cautious Optimism

The period since the onset of Covid has been tumultuous to say the least. Last year, rising inflation drove markets and policy, stoking fears of recession. Now disinflation is well underway, uneven yet welcome, as central banks appear nearly done tightening—though risks remain of having gone too far as some cracks emerge. Stress persists in banking, but immediate disaster seems avoided, as systemic risks have abated. US and global growth are broadly slowing following the initial post-Covid rebound, but the former may skirt recession if policy steadies.

Supply chains have improved in China and a weaker US dollar aids other nations, especially developing ones hammered when the flight to safety bid the dollar up and Fed rate cuts sent capital home. Yet central bankers often cannot help reacting to each data point, keeping volatility high and trust in their judgment shaken when actions follow words but consequences prove still some ways behind.

Global growth is broadly downshifting but is aided by factors such as the reopening of supply chains in China and a weaker dollar, which bodes well for EM. But central bank overtightening is still a meaningful risk. Central bankers talk about the long and variable lags that need to be considered but they often can't help overreacting to monthly inflation prints. This will continue to keep volatility and uncertainty high. Even with this backdrop, we are encouraged by the higher yields in fixed-income and our view is that investors are best served by higher-quality credits.

Summary of Our Investment Outlook

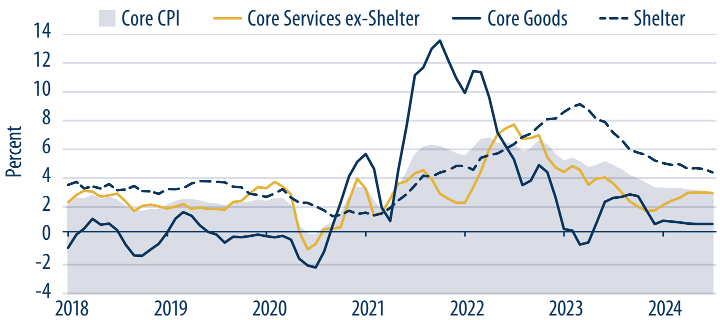
- We continue to expect a soft landing; the US will avoid a recession.
- Inflation should continue to decelerate, albeit unevenly, as the long and variable lags with which monetary policy works continue to disseminate.
- The case for fixed-income is now very strong in our view, but we think investors are best served by moving up in quality.

Inflation Outlook

We all know how we got here. Inflation came in strongly with all the Covid-related stimulus. Unprecedented monetary and fiscal policy experiments kept the wheels churning until DM economies acquired vaccines and moved to reopen, essentially restarting the business cycle, which was a major demand shock amid tight supply constraints. The Russia/Ukraine War made matters worse, driving up energy prices and disrupting supply chains, as did China's zero-Covid policy. The tailwinds to inflation have largely abated or turned into headwinds. Fiscal policy has been muted although still considered stimulative given the large deficit.

These headwinds to inflation should be cause for caution among central banks. Fed members are talking about the need to pause, citing the long and variable lags to its policy playing out. Inflation is clearly trending lower but continues to be uneven. Core CPI has been sticky, but continues to decline as seen in June readings. Generally, US and global inflation data have been surprising sharply to the downside. All DM central banks are tightening together, with the lags and feedback loops all hitting at the same time. This has meaningfully changed the projection of global inflation going forward, further fueling our optimism.

Exhibit 1: Core CPI and Component Forecasts(6-Month Annualized Rate)



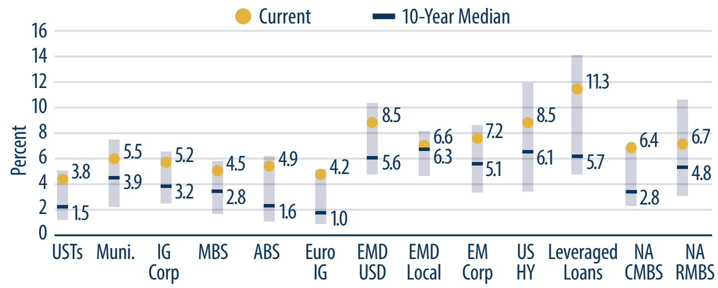
Source: Bureau of Labor Statistics, Western Asset. As of 30 Apr 23. There is no assurance any forecast, projection or estimate will be realized.

Reinforcing the Case for Fixed-Income

Valuations Have Been Restored

- One benefit following the recent rough patch is that bond yields and valuations have been restored—investors are now much more likely to find opportunities for enhanced yield in fixed-income (Exhibit 2).
- More attractive valuations amid falling inflation sets the table for a more promising investment environment.
- With valuations in better shape, inflation slowing and volatility down, the case for fixed-income today is very strong in our view.

Exhibit 2: Yield-to-Worst Across Fixed-Income Sectors (Past 10 Years)



Source: JPMorgan. As of 31 May 23. ***Past performance is not an indicator or a guarantee of future results.****

The Case for High-Quality Credit

- With higher yields overall in 2023, we favor higher-quality credit.
- Investment-grade corporate bonds and agency mortgage-backed securities (MBS) are high-quality sectors that now have substantially more yield than they have over the past decade.
- While we expect to avoid a recession in the US, there remains the possibility of a hard landing. In that environment, higher quality spread products should perform better than lower quality.

Western Asset Investment Themes

Asset Class	Our View
Overall Risk Assets	While tight monetary policy risks inducing more market volatility, high yields likely compensate investors if inflation ebbs as expected. Short-term bonds may shelter risks but curb returns, and risk tolerance determines comfort moving out the curve. We favor moving up in quality.
Investment-Grade	Spreads suggest muted upside but policy mistakes could introduce threats, so higher-quality issues are preferred for balance, especially given the attractive yields. Investment-grade remains attractive, but may face downside risks if recession yet hits.
High-Yield & Bank Loans	Distressed credits pose landmines, yet bargains may be identified through careful issue selection; with recession unlikely, lower-rated credit's higher yields may be attractive but pose increase risks.
Structured Product	Residential credit has a cushion but commercial markets continue to struggle, and while mortgages are always complex, success relies on deep dives identifying strong credits and terms. Easy profits won't emerge but housing should remain stable, so values may be found in select agency RMBS.
EM Debt	Declining inflation should give central banks room to pause or even ease as global activity stabilizes, which could be a boon for EM where monetary policy could shift from a headwind to a tailwind.

**Sources: Bloomberg, FactSet, J.P. Morgan Credit Research, J.P. Morgan Asset Management. US Treasuries (USTs) are represented by the Bloomberg US Treasury Index; municipals are represented by the Bloomberg Municipal Bond Index; investment-grade (IG) corporate is represented by the Bloomberg US Corporate Index; mortgage-backed securities (MBS) are represented by the Bloomberg US MBS Index; asset-backed securities (ABS) are represented by the Bloomberg ABS Index; Euro IG is represented by the Bloomberg Euro Aggregate Corporate Index; emerging market debt (EMD) USD is represented by the JP Morgan EMIGLOBAL Diversified Index; EMD Local is represented by the JP Morgan GBI-EM Global Diversified Index; EM Corporate is represented by the JP Morgan Corporate Emerging Markets Bond Broad Diversified Index (CEMBI Broad Diversified); US high yield (HY) is represented by the Bloomberg US Corporate High Yield Index; leveraged loans are represented by the JP Morgan Leveraged Loan Index; non-agency (NA) commercial mortgage-backed securities (CMBS) are represented by the NA component of the Bloomberg CMBS IG Index; NA residential mortgage-backed securities (RMBS) are represented by the JPMorgan NA RMBS Credit Index.*

Yield-to-worst is the lowest possible yield that can be received on a bond apart from the company defaulting. All sectors shown are yield-to-worst except for municipals, which is based on the tax-equivalent yield-to-worst assuming a top-income tax bracket rate of 37% plus a Medicare tax rate of 3.8%.

Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Important data provider notices and terms available at www.franklintempletondatasources.com.

DEFINITIONS

The **Bloomberg US Treasury Index** measures US dollar (USD)-denominated, fixed-rate, nominal debt issued by the US Treasury.

The **Bloomberg Municipal Bond Index** covers the USD-denominated long-term tax-exempt bond market.

The **Bloomberg US Corporate Bond Index** measures the investment-grade, fixed-rate, taxable corporate bond market.

The **Bloomberg US Mortgage-Backed Securities (MBS) Index** tracks fixed-rate agency mortgage-backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The **Bloomberg ABS Index** is the asset-backed securities (ABS) component of the Bloomberg US Aggregate index and comprises credit- and charge-card receivables, autos loan receivables and utility receivables.

The **Bloomberg Euro Aggregate Corporate Index** measures the corporate component of the Euro Aggregate Index. It includes investment-grade, euro-denominated, fixed-rate securities.

The **JP Morgan EMBI Global Diversified Index** is a uniquely weighted USD-denominated emerging markets sovereign index. It has a distinct diversification scheme, which allows a more even-weight distribution among the countries in the index.

The **JP Morgan GBI-EM Global Diversified Index** consists of regularly traded, fixed-rate, domestic currency government bonds, which international investors can readily access. It excludes countries where local market investing is subject to explicit capital controls, but eligibility consideration does not factor in regulatory/tax hurdles.

The **JP Morgan Corporate Emerging Markets Bond Broad Diversified Index (CEMBI Broad Diversified)** is a uniquely weighted version of the CEMBI. It comprises only USD-dominated emerging market bonds. The countries represented in the CEMBI Broad Diversified are the same as those in the CEMBI.

The **Bloomberg US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and Standard & Poor's is Ba1/BB+/BB+ or below.

The **JP Morgan Leveraged Loan Index** is a market-weighted index that tracks the performance of institutional leveraged loans.

The Non-Agency (NA) component of the **Bloomberg Commercial Mortgage-backed Securities (CMBS) Investment Grade Index** measures the market of US Non-Agency conduit and fusion CMBS deals with a minimum current deal size of $300 million.

The **JP Morgan Non-Agency (NA) Residential Mortgage-backed Securities (RMBS) Credit Index** tracks a combination of sector- and vintage-level jumbo, CRT (credit risk transfers) and legacy RMBS, reflecting the outstanding debt in the market.

WHAT ARE THE RISKS?

Past performance is no guarantee of future results. Please note that an investor cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.

Equity securities are subject to price fluctuation and possible loss of principal. **Fixed-income** securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **International investments** are subject to special risks including currency fluctuations, social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. **Commodities** and **currencies** contain heightened risk that include market, political, regulatory, and natural conditions and may not be suitable for all investors.

U.S. Treasuries are direct debt obligations issued and backed by the "full faith and credit" of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity. Unlike U.S. Treasuries, debt securities issued by the federal agencies and instrumentalities and related investments may or may not be backed by the full faith and credit of the U.S. government. Even when the U.S. government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting from declines in the market value of these securities.

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